AUDIT DIVISION STATISTICAL STUDY

The following information is based on 100% of the audits completed, taxpayers assisted and special projects conducted during Fiscal Year 2004 and addresses the requirements set forth by IC 6-8.1-14-4(2).

(See Page 45 for an index of exhibits and charts included.)

Taxpayers Served in District Offices

Taxpayer assistance is available in all district offices. Each office has a taxpayer assistance supervisor and assistant who perform taxpayer service functions, as well as other office support responsibilities. Each office has at least one field investigator who supports taxpayer assistance and performs collection functions in the district. Contract employees are available during peek periods to support taxpayer assistance.

The "Taxpayer Assistance Report-Fiscal Year 2004" (Exhibit A) provides the number of taxpayers assisted (in person and by telephone) and the amount of money collected and assessed in each office by the taxpayer assistance program. Exhibit A reveals that during Fiscal Year 2004 district offices assisted 141,270 taxpayers in person and 157,868 taxpayers through telephone contact. Total taxpayers served by the district offices is 299,138.

The district office in Clarksville served 23,468 taxpayers in person, the highest number of any district office. The Columbus District Office served 21,528 taxpayers in person, the second highest total.

The Kokomo District Office served 18,906 taxpayers by telephone, the highest number of any district office, with the Clarksville District Office coming in second at 18,695 taxpayers. Together, these telephone contacts total 24% of total taxpayer telephone contacts (157,868).

The Clarksville District Office came in highest with the total number of 42,163 taxpayers served, both by telephone and in person, while Columbus was second by serving a total of 40,016 taxpayers by telephone and walk-in assistance.

“Field Auditors Taxpayer Assistance/Special Project Statistics” (Exhibit B) provides the number of hours devoted by field auditors in the district offices to assist taxpayers and conduct special projects. The exhibit reveals that 12,584 auditor hours were channeled in this direction.

Gross Income Tax Violations

The most frequently violated gross income tax rules, 45 IAC 1.1-2-4 and 45 IAC 1.1-2-5, produced an equal number of violations. Rule 2-4 defines taxable high rate income of utilities, display advertising, sale of real estate, rentals and extension of credit while Rule 2-5 defines taxability of gross receipts from services. Violations (26 each) of these rules accounted for 14.69% each of all violations of the gross income tax rules in the statistics. Rule 45 IAC 1.1-2-4 was the most violated rule in the 2003 report with 16.78% while Rule 2-5 was the second most frequently violated rule in 2003 accounting for 14.73% of gross income tax violations.

Ranking second are IAC 1.1-2-2 and IAC 45 1.1-3-3 with equal violations. Rule 2-2 defines taxable low rate gross income of retail and wholesale sales, display advertising, dry cleaning and laundry service, rental of water softening equipment, rental of rooms, lodging, booths and similar accommodations and commercial printing. Rule 3-3 defines the interstate commerce exemption as applied to gross receipts. Violations (20 each) of these rules accounted for 11.30% each of all violations of the gross income tax rules in the 2004 statistics. As noted above, Rule 2-5 ranked second in violations in the 2003 report. Rule 2-2 ranked third in the 2003 study with 37 (12.67%) infractions. Rule 3-3 did not appear in the top three rules violated in 2003 but was the second most frequently violated rule in the 2002 statistics accounting for 35 (10.61%) of infractions.

Sales/Use Tax Violations

The most frequently violated sales and use tax rule is 45 IAC 2.2-3-20. Rule 3-20 states that if the seller of tangible personal property for storage, use or consumption in Indiana fails to collect the appropriate tax, the purchaser of such property must remit tax directly to the Department. This rule produced 258 violations (12.28%) of the sales and use tax infractions. In the 2003 study, Rule 3-20 accounted for 14.67% of sales and use tax infractions and also ranked first. This rule also ranked first in the 2002 study accounting for 12.72% of sales and use tax infractions.

The second most frequently violated sales and use tax rule is 45 IAC 2.2-3-4. Rule 3-4 imposes use tax on “tangible personal property, purchased in Indiana, or elsewhere in a retail transaction, and stored, used or otherwise consumed in Indiana…unless the Indiana state gross retail tax (sales tax) has been collected at the point of purchase.” This rule accounted for 239 infractions or 11.38% of sales and use tax statute violations. Rule 3-4 ranked second in the 2003 study with 378 infractions (10.18%). The second most violated sales and use rule in 2002 was 45 IAC 2.2-5-8 (11.25%) (explained in next paragraph). 45 IAC 2.2-3-20 (explained above) was the second most violated rule in the 2001 and 2000 studies accounting for 500 and 664 violations respectively.

The third most violated rule for the 2004 fiscal year is 45 IAC 2.2-5-8. Rule 5-8 clarifies sales and use tax by providing examples of taxable and nontaxable sales of manufacturing machinery, tools and equipment used in direct production and other activities. Failure of taxpayers to comply with this rule accounts for 195 or 9.28% of the sales and use tax infractions. Rule 5-8 ranked third in the 2003 study and second in the 2002 study with 363 and 535 infractions. Rule 3-4 with 481 violations ranked third in violations in 2001 study.

Corporate Adjusted Gross Income Tax Violations

Corporate taxpayers violated adjusted gross income Rule 45 IAC 3.1-1-8 more than any other rule. This rule states that taxable income as defined in the Internal Revenue Code is modified in several ways to arrive at Indiana adjusted gross income. Violations (40) of this rule accounted for 15.81% of the total violations in the 2004 study. Rule 1-8 was also the most violated rule in 2003 with 76 or 14.10% of total infractions; 2002 with 94 or 12.21% of infractions; and 2001 with 119 or 13.52% of total infractions. The 2000 report revealed Rule 1-97 ranked first for adjusted gross income infractions with a 22.00% violation rate. Rule 1-97 addresses returns and reports filed by withholding agents.

Rule 45 IAC 3.1-1-9 was the second most frequently violated rule under this study. This rule discusses the net operating loss deduction in computing Indiana Adjusted Gross Income for corporations. These violations (27) account for 10.67% of the total violations for 2004. Rule 1-1 ranked second in the 2003 study with 63 violations accounting for 11.69% of infractions. 45 IAC 3.1-1-9 ranked second in the 2002 report with 10.26% of violations. Rule 45 IAC 3.1-1-97 (explained below) ranked second in the 2001 study with 115 violations accounting for 13.07% of the total violations.

The third most frequently violated rule is 45 IAC 3.1-1-97. Rule 1-97 addresses returns and reports filed by withholding agents. Violations (26) of this rule accounted for 10.28% of the violations of adjusted gross income tax rules. The 2002 study revealed 45 IAC 3.1-1-97 ranked third with 72 (9.35%) of the violations. 45 IAC 3.1-1-9 was the third most violated rule in the 2003 and 2001 studies accounting for 61 (11.32%) and 90 (10.22%) of the violations of adjusted gross income tax rules. The 2000 violations of 45 IAC 3.1-1-9 also ranked third with 8.62%.

Amounts of Tax Assessed

Exhibits C, D and E display the amount of assessments (refunds) of the gross income tax, sales tax and adjusted gross income tax administrative rules, respectively. "Total assessments" for any tax type represent gross assessments less amounts refunded.

The amount assessed or refunded for each of the most frequent violations and the percentage of the amount to total net assessments are presented below:

Gross Income Tax—Exhibit C:

	Amount Assessed	Percentage of All Assessments
45 IAC 1.1-2-5*	$6,209,277	40.76%
45 IAC 1.1-2-4*	$1,050,220	6.89%
45 IAC 1.1-3-3**	$ 541,733	3.56%
45 IAC 1.1-2-2**	$ 319,866	2.10%

Equal Infractions for Number 1 (*) and Number 2 (**)

Sales/Use Tax—Exhibit D:

	Amount Assessed	Percentage of All Assessments
45 IAC 2.2-3-20	$2,741,304	11.77%
45 IAC 2.2-3-4	$2,338,798	10.04%
45 IAC 2.2-5-8	$2,576,597	11.06%

Corporate Adjusted Gross Income Tax—Exhibit E:

	Amount Assessed	Percentage of All Assessments
45 IAC 3.1-1-8	$25,634,731	43.44%
45 IAC 3.1-1-9	$(1,116,228)	(1.89%)
45 IAC 3.1-1-97	$ 180,432	.31%

Industry /Business Most Frequently In Violation

<u>Gross Income Tax</u>
For the twelfth consecutive reporting period, taxpayers engaged in manufacturing most frequently violated the gross income tax rules. This group committed 48 violations or 27.12% of the total violations. The gross income tax rule most frequently violated by this group of taxpayers was 45 IAC 1.1-3-3. This rule defines the interstate commerce exemption as applied to gross receipts.

The second largest number of gross income tax violations was committed by taxpayers providing repair, personal services and other services. This group committed 44 infractions or 24.86% of the total violations for 2004. The most frequently violated rule of this group was 45 IAC 1.1-2-5 which defines gross receipts derived from services.

<u>Sales and Use Tax</u>
For the 2004 reporting period, repair, personal services and other services are the industries with the most infractions. They accounted for 561 violations or 26.70% of the total sales and use tax violations. The most frequently violated rule by these taxpayers was 45 IAC 2.2-5-12 which defines exemption from sales tax of tangible personal property consumed in direct production when producing tangible personal property by manufacturing, processing, refining or mining.

Wholesale, retail and transportation businesses had the second most frequency of violations for the sales and use tax rules. There were 386 violations committed by this group representing 18.37% of the total violations. The rule most frequently violated by this group was 45 IAC 2.2-3-4, which imposes use tax on “tangible personal property, purchased in Indiana, or elsewhere in a retail transaction, and stored, used or otherwise consumed in Indiana…unless the Indiana state gross retail tax (sales tax) has been collected at the point of purchase.”

<u>Adjusted Gross Income Tax</u>
Repair, personal service and other service providers with 72 infractions, were the most frequent violators of adjusted gross income tax rules. This figure represents 28.46% of the total adjusted gross income tax violations. 45 IAC 3.1-1-1, which defines adjusted gross income for individuals in relationship to Section 62 of the Internal Revenue Code, accounted for the most infractions in this class.

The manufacturing industry ranked second in violation of the adjusted gross income rules. They committed 62 infractions or 24.51% of the adjusted gross income tax violations. 45 IAC 3.1-1-9 was the most violated rule by manufacturers. Rule 1-9 discusses the modifications to Internal Revenue Code Section 172 to determine Indiana adjusted gross income for corporations.

Special Tax Violations

Exhibit G provides the special tax assessments and refunds by citation.

Article VIII (citation R800 on exhibit) of the International Fuel Tax Agreement (IFTA) was the most frequently violated special tax item in the study. It specifies the taxable event is the consumption of motor fuels in the propulsion of qualified motor vehicles, except fuel consumed that is exempt from taxation by a jurisdiction. All motor fuel acquired that is normally subject to consumption tax is taxable unless proof to the contrary is provided by the licensee. Article VIII was violated 182 times and yielded $487,571 in net assessments for the State of Indiana. This represents 24.20% of total violations and 53.15% of net assessments.

The exhibit also reveals that Article X (citation R1000 on exhibit) of the International Fuel Tax Agreement (IFTA) was the second most frequently violated section of the special tax statutes. This Article discusses how taxpayers can obtain credit for tax previously paid on purchases of fuel at the pump. It also lists the records needed to substantiate the refund request. This article was violated 180 times accounting for 23.94% of the total violations. These violations resulted in a net refund of ($57,386).

The taxpayer group most frequently in violation of the special tax statutes and IFTA Articles was the wholesale, retail and transportation industries. This group committed 360 violations accounting for 47.87% of the total infractions. Article X of the International Fuel Tax Agreement was most frequently violated by the wholesale, retail and transportation industries.

Miscellaneous Code Violations

Exhibit F provides the assessment amounts for the following:

Financial Institutions Tax
Tax Administration
Food and Beverage Tax
Innkeeper's Tax
Charity Gaming

A review of the miscellaneous code violations data reveals that IC 6-8.1-4-2 was violated 16 (12.12%) times in the 2004 study. These violations yielded ($29,607) in net refunds. Chapter 4-2 discusses examination of records maintained by a taxpayer. In the 2003 study, IC 6-8.1-9-1 (which discusses filing claims for refunds, time limitations, hearings and appeals for refunds) produced 57 (18.45%) infractions. IC 6-8.1-4-2 was the most violated rule in the 2002 study with 24 (14.46%). 45 IAC 15-9-2 was the most violated rule in the 2001 study. Rule 9-2 defines the statute of limitations as it applies to refunds.

The 15 violations of 45 IAC 15-9-2 was the second most violated rule in this category in 2004. It yielded a total of $(1,369,297) in net refunds. Rule 9-2 is defined above. Rule 9-2 was the second most violated citation in the 2003 and 2002 studies.

Number of Years in the Audit Period

The audit period consistently averages three years.

Use of Professional Tax Preparation Assistance

The services of professional preparers were used in the preparation of 75.50% of the corporate income tax returns and 11% of the sales tax returns. These findings remain consistent with the previous years' reports.

Filing of Appropriate Tax Returns

Rule 45 IAC 3.1-1-92 (Exhibit E) requires qualifying corporations to make estimated tax payments. Taxpayers in violation of this rule either failed to file estimated income tax returns or failed to remit the appropriate amount of tax. For the fiscal year ending in 2004, no activity was recorded. The 2003 study indicated 8 violations of this rule, resulting in assessments in the amount of $12,863 and refunds totaling ($110,617).

Indiana Code 6-8.1-10-2.1 (Exhibit F) revealed no violations during the 2004 study period. This section specifies the penalty to be imposed if a taxpayer fails to file an appropriate return or pay the full amount of tax due. Violations of this section in the 2003, 2002, and 2001 studies were zero.

Special Projects

The project of identifying taxpayers with delinquent filing periods reported in the 2003 Report was continued during the 2003 Fiscal Year. Examination of data generated by this project identified and closed inactive accounts; encouraged delinquent taxpayers to file correct returns; and collected substantial funds related to the filings.

Accounts Worked: 13,341 Accounts Closed: 2,724 Funds Collected: $15,229,806